are too low, this could lead to a price squeeze for CLECs entering the access business that rely unbundled network elements.

E. A Forward-Looking Prescription of Access Rates is Not Required by the Law.

Several parties argue that the Commission is compelled by Sections 201 and 202 of the Communications Act of 1934 and Section 251 of the Act to price access at forward-looking costs.[28] Their argument is that, since the Commission found that unbundled network elements must be priced at forward-looking costs, then it would be unlawfully discriminatory and otherwise unreasonable to set different prices for access services that perform the same functions. This argument, is completely without merit since it fails to take into account both the legal and factual contexts in which the Commission made its determination concerning the pricing of unbundled network elements.

In its interconnection orders,[29] the Commission effectively determined that unbundled network elements and exchange access services provided by ILECs are essentially two separate but overlapping regimes. Specifically, the Commission found that IXCs could purchase unbundled network elements:

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[28] *See, e.g.*, AT&T at 11-12.

[29] In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-96, First Report and Order, FCC 96-325 (released August 8, 1996); Second Report and Order, FCC 96-333 (released August 8, 1996) ("Interconnection Order"); and Order on Reconsideration, FCC 96-394 (released September 27, 1996) ("Interconnection Reconsideration Order").

for the purpose of providing exchange access services to themselves in order to provide interexchange services to consumers.[30] However, pursuant to Section 251(g) of the Act, access services are to remain in effect until the Commission decides otherwise. The Commission concluded that the purpose of 251(g):

> is to preserve the right of interexchange carriers to order and receive exchange access services even if such carriers elect not to obtain exchange access through their own facilities or by means of unbundled elements purchased from an incumbent.[31]

Even assuming that the Commission properly decided to prescribe that rates for unbundled network elements be based on forward-looking costs,[32] there is certainly no requirement that those rates apply to access charges. In setting forth its standard for unbundled elements, the Commission noted the special circumstances that unbundled elements were to play. Their primary purpose is for use by new market entrants competitors to provide services in competition with the ILECs. The Commission specifically noted:

> The 1996 Act encourages competition by removing barriers to entry and providing an opportunity for potential new entrants to purchase unbundled incumbent LEC network elements to compete efficiently to provide local exchange services. We believe that the prices that potential entrants pay

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[30] Interconnection Order at ¶ 356.

[31] *Id.* at ¶ 362.

[32] Ameritech does not agree that it is appropriate to prescribe that unbundled elements be priced at forward-looking cost for two reasons articulated in the recent appeal of the Commission's Interconnection Order that has been consolidated before the Eighth Circuit Court of Appeals. First, the Act reserves to the states the authority over rates for, inter alia, network elements; second, the Commission's articulated standard of forward-looking hypothetical costs discourages competition and is confiscatory in violation of the Constitution.

> for these elements should reflect forward looking economic costs in order to encourage efficient levels of investment and entry.[33]

Thus, the main potential purchasers of unbundled network elements are new competitors seeking to challenge ILECs' established business. That is not the case for access charges. Except for BOC affiliates, the purchasers of access services will be, for the most part, established market participants.

AT&T's allegation that price capped rates are now unlawful simply because of a change in the competitive market[34] is far-fetched. First, AT&T misquotes the Commission. AT&T alleges that the Commission says that price cap restraints are inconsistent with the competitive market; but the Commission really said that its Part 69 access charge rate structure is inconsistent with the competitive market.[35] Nonetheless, that does not make reliance on price caps in the transition to full competition unjust and unreasonable per se. Certainly, when coupled with the other market-based triggers, price caps provides a more than adequate check on any ILEC ability to abuse its position.

Similarly, there is nothing in Section 201 or 202 that would require that competitive rates be tied in any particular fashion to costs. If that were the case, it is likely that AT&T's own toll rates today are unjust and unreasonable to the

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[33] Interconnection Order at ¶ 672.

[34] AT&T at 11.

[35] NPRM at ¶ 6.

extent that they exceed its cost. Moreover, the reasonableness of the distinction between the rates for unbundled network elements and the rates for access charges (though the two will undoubtedly converge) lies in the different functions served by each set of rates. As noted above, the primary function of unbundled network elements is to serve as a source of supply to new market entrants that will compete against ILECs in the provision of exchange access and local exchanges services. Access services, on the other hand, are currently provided to a significant list of well-established providers of long distance services.

Moreover, and probably more importantly, with unbundled network elements set at hypothetical forward-looking costs, there must be some services left to recoup the shortfall between forward-looking cost and embedded cost. Certainly, the more services that are "prescribed" at forward-looking cost, the less opportunity there will be for the ILEC to recoup all of its reasonable and prudent embedded costs. Such a decision would only increase the constitutional problems associated with that type of prescription.

F. The Prescriptive Approach to Access Rates Will Not Benefit The Average Consumer.

Although, there has been considerable debate over the extent to which long distance carriers have passed along the extensive reductions in access rates that have occurred since divestiture, it cannot be denied that the average residential ratepayer has not benefited to the full extent of the access rate reductions in the

1990's. Certainly the millions of consumers that have not chosen or are not eligible for IXC discount plans are worse off as standard rates have risen while IXC costs have fallen. While the IXCs now promise to reduce rates to reflect these proposed access reductions, there is nothing which compels them to do so, nor is there any guarantee that those reductions, if they are made, will benefit the average ratepayer. What is certain is that if access rates are reduced below reasonable economic levels, customers will lose the benefits of real facilities-based competition, innovation and the network investment necessary to provide high quality, technologically advanced services.

In conclusion, the prescriptive approach offers no benefits but imposes a potentially significant barrier to the evolution of competition and the advanced telecommunications network. Implementation of the prescriptive approach would impose significant inefficiencies on access pricing and subvert the competitive process. Efficient entry and investment will be hampered by the wrong pricing signals, signals produced by regulation not by consumers. The approach is an overly onerous substitute for the existing tested safeguards and may inadvertently stifle competition and create its own price squeeze on new access competitors. Finally, there is no guarantee that the access rate reductions will be transformed into long distance savings for millions of consumers.

IV. THE ACCESS RATE STRUCTURE SHOULD PERMIT RECOVERY OF COSTS IN A WAY THAT IS MORE REFLECTIVE OF THE MANNER IN WHICH COSTS ARE INCURRED.

Ameritech agrees with the general consensus that certain inefficiencies could be avoided if the current access structure were reconfigured to be more reflective of the manner in which costs are incurred.[36] To ensure maximum industry efficiency, these changes should apply to all ILECs, not just price cap carriers. Despite this agreement, certain parties wish to carve out exceptions when it suits their purpose. Specifically, the current unitary rate structure for tandem-switched transport should not continue to be required since it bears little relation to the manner in which costs are incurred. In addition, the TIC represents the recovery of real costs and therefore, to the extent that cost recovery is not moved to other rate elements, the charge should not be flash-cut but, at most, phased out over a reasonable period and billed to access purchasers on a competitively neutral basis during the transition.

A. The Unitary Rate Structure for Tandem-Switched Transport Does Not Reflect the Manner in Which Costs Are Incurred.

Certain parties argue for retention of the current unitary rate structure for tandem-switched transport -- by which purchasers are assessed a single per minute of use ("MOU") charge based on the air mileage between the end office

[36] *See, e.g.*, AT&T at 49-60; TCG at 22; USTA at 57-63.

("EO") and the serving wire center ("SWC").[37] However, as noted in Ameritech's comments, the manner in which costs are caused is better reflected in a bifurcated rate structure which treats the link between the SWC and the tandem as any other form of dedicated transport -- on a flat-rate, mileage sensitive basis. Under such a bifurcated rate structure, it is only the truly common transport portion that would be charged on an MOU-basis -- the transport between the ILEC's EO and its tandem switch.

Sprint argues that a bifurcated rate structure's use of tandem locations in calculating mileage-sensitive rates would create an incentive for ILECs to "increase their local transport revenues by inefficiently locating their tandem switches away from their IXC customers and their concentrations of traffic."[38] In Ameritech's case, however, tandems have been deployed to maximize network efficiencies. In order to re-route traffic inefficiently, ILECs would need to remove facilities already in place and build new facilities to other tandems. This would result not only in inefficient IXC local transport routing, but would also cause ILECs' local exchange and intraLATA toll services to be inefficiently routed as well. Such misspent capital outlays and inefficient network configuration simply would not make good business sense. While Ameritech strongly supports a bifurcated rate structure, it has no plans to relocate its tandems, most of which

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[37] *See, e.g.*, Sprint at 21-25.

[38] *Id.*

have been in place since before IXCs started placing their POPs throughout the region.

A number of other parties agree that a bifurcated rate structure for tandem-routed transport is proper. For example, AT&T states in its comments:

> Because interoffice facilities from the IXC's serving wire center ("SWC") to the access tandem are dedicated to the IXC's own use, fixed monthly charges should apply, reflecting the way these costs are incurred. This will provide appropriate incentives for IXCs to order facilities so as to achieve optimal loading of their traffic. Conversely, the use of facilities from the access tandem to the end office should be priced on a per-minute basis, as these facilities are used in common with other traffic handled by the LEC. Principles of cost-causation also support mileage sensitive rates based on the mileage of each specific link ordered by the customer. Cost-based mileage charges would encourage carriers to order facilities in a manner that minimizes routing distances, as well as to place their POPs in the most efficient locations.[39]

In addition, comments filed by BellSouth, Bell Atlantic and NYNEX, and Pacific Telesis all support a bifurcated rate structure. In its comments, BellSouth says, "...a flat-rate structure should apply for dedicated transport between the customer's SWC and any other point designated by the customer, such as an access tandem..."[40] The joint comments filed by Bell Atlantic and NYNEX state that:

> The Commission should eliminate an IXC's interim ability to select a usage-sensitive option for its tandem-switched transport from a tandem office to the IXC's serving wire center. Instead, IXCs using tandem-switched transport should be required to pay for a dedicated link between the serving

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[39] AT&T at 59-60.

[40] BellSouth at 71.

> wire center and the access tandem as dedicated trunk transport. If all IXCs were required to purchase these services as direct trunked transport on a flat-rate basis, they would have the incentive to size their requirements based on their actual needs, and they would select the most economically efficient arrangements to meet those needs.[41]

Pacific Telesis states:

> We support a combination of flat-rated (between serving wire center (SWC) and access tandem) and usage sensitive (between access tandem and end office). We support the latter since the SWC to tandem facilities, like those that directly connect the SWC to an end office (and which are flat-rated), are dedicated to an IXC and do not vary with usage. On the other hand, the common transport facilities (those connecting the access tandem to an end office) are not dedicated to an IXC and need to be priced on a usage-sensitive basis...[42]

Ameritech agrees with Sprint that an IXC should pay the costs associated with any over-trunking that it uses.[43] A bifurcated rate structure that includes a flat-rate charge from the SWC to the tandem coupled with a port charge would put in place the appropriate mechanism to accomplish that result.

A bifurcated rate structure for tandem-routed traffic, as proposed by Ameritech, is the most equitable way to effect efficient use of tandem-switched transport.

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[41] Joint Comments of Bell Atlantic and NYNEX at 41.

[42] Pacific Telesis at 70.

[43] Sprint at 27.

B. Because it Supports Affordable Local Exchange Service, the Transport Interconnection Charge Should Not Be Flash-Cut.

Certain parties insist that the transport interconnection charge ("TIC") no longer has any place in the world of access and should be eliminated immediately.[44] However, this ignores the historical source of the TIC itself. As Ameritech pointed out in its comments and in its December 6 Letter,[45] a substantial portion of the TIC contributes to ILECs' ability to maintain affordable basic exchange rates. Thus, even though specific portions of the TIC may be allocated to and recovered by other specific rate elements -- *e.g.*, tandem switching and SS7-related charges -- the remainder of the TIC should be billed to interstate providers of telecommunications services in a competitively neutral manner.[46] The TIC should no longer be billed on a per MOU basis, but instead should be billed on a competitively neutral or flat rate basis similar to the proposals to bill CCL in the future.

Moreover, a phase-out of the TIC should be mandated only if it is over a period of time of sufficient length (five years) to permit ILECs and state commissions to manage the revenue loss, and only if the Commission adopts the

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[44] *See, e.g.*, AT&T at 58; MCI at 86.

[45] Ameritech Comments at 20-23; Letter from Anthony Alessi, Federal Relations Director, Ameritech, to William F. Caton, Acting Secretary, FCC, December 6, 1996 ("December 6 Letter"), included with Ameritech's Comments as Attachment A.

[46] This is similar to the manner in which the costs of the loop and its associated port should be billed via the Loop/Port Recovery ("LPR") charge to the extent those costs are not recovered from the end user.

market-based approach for access reforms to permit ILECs rate flexibility sufficient to manage the revenue loss, and only if it permits price cap LECs to target mandatory price cap reductions to the TIC during the phase-out period. Moreover, states should begin and conclude proceedings that permit ILECs to recover the intrastate portion of the loop and line port costs, currently being partially subsidized by TIC revenues, from end user rates or state universal service funding mechanisms.

C. Ameritech's SS7 Rates are Reasonable.

While generally approving the unbundled SS7 rate structure implemented by Ameritech,[47] Sprint complains that it pays nearly three times as much for SS7 signaling service functionality to Ameritech than it does to Pacific Telesis.[48] In response, Ameritech would note that Pacific Telesis signaling may have a different configuration that makes it less expensive to use for Sprint's particular needs. More importantly, when Ameritech introduced the unbundled SS7 structure, it simultaneously reduced its local switching rate by an amount equivalent to the revenue that would be generated by the Signal Formulation rate element and reduced the TIC by an amount equivalent to the revenue that would be generated by the Signal Switching, Signaling Transport, Signal Tandem Switching rate elements. Pacific Telesis made no such adjustments. When these

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[47] Sprint at 30-31.

[48] *Id.* at 32.

adjustments are taken into account Ameritech suspects that the difference that Sprint complains of will disappear.

D. Access Charges Should Not Be Reduced to Reflect Receipt of Universal Service Support.

Several commenters argue that it is necessary to require ILECs to reduce access charges dollar-for-dollar by the amount of universal service funds received.[49] Certainly, if Long Term Support costs are replaced by a universal service subsidy mechanism, then ILECs' access rates -- particularly the carrier common line ("CCL") charge -- should be reduced dollar-for-dollar by the amount of the reduction in their Long Term Support payments. When a carrier receives universal service support, however, that support is intended to assist the carrier in keeping local exchange rates lower than they would otherwise have been. The proposal of the commenting parties appears to foil that intent by requiring the recipient carrier to use those funds instead for reducing access charges. Ameritech suggests that this is ludicrous. The same is true for those "support funds" that carriers will receive to compensate them for the discounted portion of the rates for telecommunications services provided to schools, libraries and rural health care providers. These support payments are designed to support specific services -- not to enable recipient carriers to reduce access charges.

[49] *See, e.g.*, Sprint at 29.

E. Sufficient Time is Needed to Implement Rate Structure Changes.

Finally, Ameritech would request that the Commission provide carriers with sufficient time to do the necessary systems work to implement any modified rate structure. As Ameritech noted in its comments, no less than nine months of lead time should be given to provide both access providers and access customers sufficient time to smoothly implement those changes. Attachment B contains detailed descriptions of the specific systems work and the time periods involved. As Ameritech also noted in its comments, the Commission allowed carriers a full year to implement the rate changes involving transport restructuring.[50] The changes involved with this proceeding will likely be at least as dramatic as those involved in transport restructuring.

[50] In the Matter of Transport Rate Structure and Pricing, CC Docket No. 91-213, Report and Order FCC 92-422 (released October 16, 1992) 7 FCC Rcd. 7006 at ¶ 6.

V. CONCLUSION.

The Commission is headed down the right track with its proposed rate structure modifications and market-based approach for reforming access charges. Anything less than letting the market work would be inconsistent with the pro-competitive, deregulatory mandates of the Act and the Commission's own goal to promote a fully competitive marketplace. A "prescriptive" approach to reforming access would ignore that already significant changes taking place in the access market in response to competitive pressure -- ILEC reductions and attempts to introduce new services and pricing plans -- and virtually ensure that efficient competition does not emerge.

The plan the Commission ultimately adopts should remove and make explicit subsidies currently embedded in access charges, realign the access rate structure to more closely reflect cost causation, and provide significant relief from pricing restrictions and price cap regulation as the stage for local competition is set and actual competition fully develops.

The competitive environment is developing quickly. It is important that the Commission keep in mind its pro-competitive, deregulatory goals and, in this proceeding, carefully modify access regulations to remove existing economic inefficiencies and distortion. It must not inadvertently create new ones.

Respectfully submitted,

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Dated: February 14, 1997

ATTACHMENT A

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STATEMENT OF KENNETH GORDON

on behalf of Ameritech

February 14, 1997

STATEMENT OF KENNETH GORDON

I. QUALIFICATIONS

I am Senior Vice President of National Economic Research Associates, Inc. (NERA), One Main Street, Cambridge, MA 02142, and have held that position since November of 1995. Immediately prior to that I was Chairman of the Massachusetts Department of Public Utilities, and before that was Chairman of the Maine Public Utilities Commission. I have been an economist since 1965, and since 1980, when I became an industry economist at the FCC, have been directly involved with developing and establishing virtually all aspects of regulatory policy for telecommunications at the federal and state levels. While I was at the Massachusetts commission, that commission undertook a proceeding to examine in detail interconnection and other issues related to the development of competition at all levels of telecommunications. I am the author of a paper entitled "Access, Regulatory Policy, and Competition," which was submitted as an attachment to Ameritech's initial comments in this proceeding.

II. PURPOSE

Ameritech has asked me to respond to arguments made by Drs. William J. Baumol, Janusz A. Ordover, and Robert D. Willig, in their joint affidavit filed by AT&T, and Dr. John E. Kwoka, Jr., in his "Statement on LEC Price Cap Reform," filed by MCI. In particular, I will explain why their recommendation for the Federal Communications Commission (FCC or

Commission) to adopt the proposed prescriptive approach to access reform would not be consistent with, and could actually operate counter to, the pro-competitive and economic development goals of the Telecommunications Act of 1996 (Act). I will also explain why it would be anticompetitive to withhold from Ameritech and the other ILECs the flexibility in access pricing that is appropriate given the increasingly competitive conditions in the access marketplace.

III. INTRODUCTION

Competition in the real world is a process, not a state of being, or equilibrium. Changing prices -- and, importantly, profits -- drive what Schumpeter called "a perennial gale of creative destruction."[1] Even though we know what the characteristics of the competitive outcome are, *i.e.*, productive and allocative efficiency, we never actually observe its occurrence, and we cannot accurately predict or quantify the outcome of a specific market beforehand. We can only predict with confidence that, whatever the outcome is, it will reflect shifts in the direction of these characteristics. This is because the competitive process, in its essence, is a confluence of the independent voluntary production and consumption decisions of all who participate in a market. No one entity controls this process, and no one entity has the ability to predict exactly what the competitive result will be at any given time. This inability to predict

[1] Joseph A. Schumpeter, *Capitalism, Socialism, and Democracy*, 3rd ed. (New York: Harper & Row, 1950), page 106.

outcomes is why, throughout the world, economic and political systems based on centralized, administrative control of a regulatory or other governmental authority have failed.

Even in a free-market economy, however, there are markets where the competitive process either does not exist or is ineffective. In these cases, it may be appropriate to substitute regulatory processes for the absent competitive processes, recognizing, of course, that centralized decisions of regulators will never be able to replicate the efficiency of the competitive process. In the worst case, the presence of regulation in fact may prevent the emergence of competition, thereby continuing the perceived need for regulation in a classic "Catch-22:" competition cannot emerge until regulation is relaxed, regulation will not be relaxed until competition has emerged. The local exchange and access market in this country traditionally has been subject to regulatory control because of the absence of competition, and the outcome predictably has strayed from a competitive result, for reasons that I described at great length in my attachment to Ameritech's initial comments.

Congress, the FCC, and a majority of state regulators have now recognized that open competitive markets, where they are feasible, are preferable to regulation in maximizing societal welfare. The decisive shift to open markets and unimpeded entry, expanded in the Act and in the actions of many state regulators prior to passage of the Act, is eloquent testimony that the rules underlying the industry have changed forever. Therefore, the challenge we now face is to allow the competitive process to unfold into telecommunications markets, and not inhibit or distort it through overly broad or unnecessary regulation. By targeting its attention to the real areas of concern, *i.e.*, interconnection of competing networks and the availability of essential facilities, Congress created the opportunity for market forces to bring the benefits of competition to ILEC services that have been traditionally regulated. Access services are one of the key services that can become fully competitive under the Act. With entry barriers removed, competitors can enter the marketplace to supply the access needs of end users and carriers.

One major piece of this puzzle is for the FCC to reform its regulation of interstate carrier access in order to:

1) revise the existing rate structure to more closely reflect economically-efficient rates;

2) allow the competitive process to develop in access markets; and

3) remove and eventually eliminate regulation of all market participants.

In its Access Reform Notice, the FCC proposes to implement the first item, but, to accomplish the latter two goals, the FCC offers for comment two distinct paths: a market-based approach and a prescriptive approach. As I described at length in my paper filed with Ameritech's initial comments, I advocate the market-based approach. Drs. Baumol, Ordover, Willig, and Kwoka have said that they prefer the prescriptive approach. I will explain in this statement how the prescriptive approach essentially is a continued application of a regulatory process that is likely to stifle and distort the development of efficient competition. Indeed, it could be regarded as a restoration of traditional cost-based regulation, with all its well-known attendant problems, since the Commission shifted to price-based regulation years ago.[2] I also

[2] In fact, Dr. Kwoka prefers to call the prescriptive approach the "cost-based" approach.

show how those who prefer the prescriptive approach are operating on the mistaken assumption that somehow regulators will be better able to predict efficient forward-looking costs than they have been at determining the prudence of historic costs. The Commission has to decide whether it will rely on competition to guide the telecommunications industry, as all recent evidence suggests Congress intended, or whether it is bent on creating competitive outcomes through regulatory means.

The central point that I would like to impress upon the Commission is that <u>any</u> regulatory process, whether it is based on embedded costs or an administrative estimate of forward-looking costs, is inferior to markets and should only be used in the <u>absence</u> of the competitive process or any reasonable prospect that one will evolve in the foreseeable future. A new layer of regulation should not appear because of impatience with the pace of change in the competitive process. Competition in access markets has been developing since the mid-1980's when competitive access providers (CAPs) first came on the scene, and has expanded significantly since then. For example, as Ameritech noted in its initial comments, CAPs have made significant investments in fiber networks in Ameritech's region, and they all have announced plans to expand into local exchange and exchange access services.

The new structure available under the Act, especially unbundled network elements at forward-looking costs, give an enormous boost to competition in this market by significantly lowering economic, in addition to legal, barriers to entry.

IV. REBALANCING CURRENT ACCESS RATES

The Commission has proposed to rebalance current access rates in order to make them more economically-efficient.[3] For example, the Commission proposes, consistent with the advice of nearly all economists who have examined the issue, to remove any non-traffic sensitive (NTS) costs from usage rates and to recover these NTS costs in flat charges in order to remove implicit subsidies but still allow ILECs to recover their costs. Such charges might be levied on either the end-user or the interexchange carrier (IXC). Such charges, properly implemented, would not constitute a general increase in rates, and would be done on a revenue-neutral basis. As I noted in my paper, I completely agree that this outcome is more consistent with pricing that would occur in a fully competitive market. Rebalancing rates is a good initial change that can help facilitate competition and immediately provide real customer benefits by sending vastly improved price signals to both consumers and producers.[4] As such, it is an important first step in the access reform effort. In its initial comments, Ameritech outlined a number of specific proposals for access rate rebalancing, which I believe to be appropriate.

Inefficient repression of long-distance calling that today costs consumers billions of dollars[5] would be reduced. The evidence also suggests that subscribership -- customer access to the network -- would not be significantly impaired. To the extent some low-income subscribers

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[3] FCC Notice, ¶¶ 55-56.

[4] Rebalancing access rates results in welfare gains for end-user customers only to the extent that IXCs' retail interexchange rates are reduced to reflect the lower traffic-sensitive access charges.

[5] Robert W. Crandall and Leonard Waverman, *Talk is Cheap*, The Brookings Institution, Washington, D.C.

were to be adversely affected by additional flat charges, the universal service portions of the Act authorize and encourage explicit, competitively neutral support to the affected customers.

In addition to providing real efficiency gains to customers (something that has always been true, even under monopoly regulation), rebalancing rates would lead to substantial acceleration of the development of efficient competition, consistent with the Act's pro-competitive goals. The need for complex determinations of competitive equality could be reduced substantially. A number of the states (Massachusetts, Illinois, California, among others) have, with respect to their own intra-state rate structures, rebalanced rates significantly -- usually in recognition that the old structures are not compatible with competition. There have been no dire consequences for customers, and opening markets to competition has been able to proceed on a simpler and more efficient basis. While Chairman of the Massachusetts Commission, I approved (enthusiastically) the fourth in a series of rebalancings that increased the charge for a residential dial-tone line (not including the federal SLC) from about $3.00 per month to just under $10.00 per month, from 1990 to 1994, with no statistically significant change in household penetration rates in the state over that period of time. All of these rebalancings were revenue-neutral, as the increases were completely offset by decreases in toll, access, and business rates. Making such changes in the current rate structure in and of itself will provide immediate benefits for customers. In fact, many of the benefits that the commenters link to adoption of the prescriptive approach will be attained through rebalancing existing rates, and thus providing to customers and competitors alike price signals more appropriately based on costs. The Commission should maintain -- indeed strengthen -- its resolve in this matter.

V. MARKET-BASED APPROACH VS. PRESCRIPTIVE APPROACH

Given that revisions in regulation are essential to achieving increased reliance on competition, the more important question is whether current access rate levels, post-rebalancing, should be governed by the competitive process and existing price cap rules, rather than administratively determining what the correct level of access rates is. This is the Commission's proposed market-based approach. Or, in the alternative, the Commission asks whether this rebalancing should also include a regulatory review of the reasonableness of the current access rates based on a forward-looking cost methodology analogous to that adopted by the Commission in the interconnection proceeding, in which case it likely would not be revenue-neutral. This is the proposed prescriptive approach.

The market-based approach will subject current access rate levels -- post rebalancing -- to the only process that can definitively determine whether and to what extent those levels are efficient -- the competitive process. This is the central purpose of the Act. In my opinion, it is simply too soon, just one year after passage of the Act and much less than one year since implementation of most interconnection agreements, to throw in the towel and conclude that competition is not working. Congress, the Commission, and the states have taken significant steps that are designed to enable a competitive local exchange and access market to develop. And enormous changes have already taken place. For example, as of this writing, some 446 interconnection agreements have been either completed (233) or are in arbitration (213) at the state level.[6] States have set rates for unbundled network elements, resale, and interconnection, and CLECs, including large companies such as MCI and AT&T are already selling local exchange services in some areas of the country. Moreover, there was competition prior to the Act, which is at least suggestive that, given the competition-enhancing provisions in the Act, such as the availability of unbundled network elements, there will be even more competition in the future. It is time now to see if it works.

Dozens of cities have alternative access providers who, until recently, have specialized in the provision of special access and, in a limited number of instances, switched access. Competition has been successful in these areas with significant penetration by the competitors into the ILECs' special access business.[7] These facilities-based providers are providing, or are preparing to provide, switched access and local exchange services through the addition of switching and other operational and marketing capabilities. Moreover, as I noted in my initial paper, with the availability of unbundled network elements, the sunk costs of entry are dramatically reduced or eliminated. Given the extensive competition in special access and the now relatively low sunk costs of entry into the switched access market, the claim of Drs. Baumol, Ordover, and Willig that future competition is uncertain is unpersuasive and does not justify the adoption of the prescriptive approach.

[6] TRDaily, February 3, 1997.

[7] Ameritech Comments, Att. D, Quality Strategies, "Summary Analysis of Access Providers."